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SUBJECT: ETHIOPIA'S SUGAR RUSH

¶1. SUMMARY: The sugar and ethanol industries have recently garnered much attention in Ethiopia, with India's ExIm Bank providing a \$640 million line of credit to fund expansion of Ethiopia's state-owned Finchaa sugar factory and construction of a new factory at Tendaho. Ethiopia is expanding sugar production both to meet rising domestic consumption and to export to Europe under the "Everything but Arms" agreement. Ethiopia's Minister of Trade and Industry is now touting sugar along with other priority sectors such as textiles and hides, skins and leather, as a focus for economic growth. Additionally, extra capacity in the country's refineries can be used to make ethanol, a biofuel that can be used in fuel blending or clean-cook stoves. Sugar is, however, a volatile place to stake a claim. The world sugar market is notorious for its fluctuations, and sugar and ethanol expansion pose significant environmental and humanitarian concerns. END SUMMARY.

#### Sector Overview

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¶2. Ethiopia currently has three operational sugar factories at Finchaa, 170 km northwest of Addis Ababa in Oromia, Wonji/Shoa 100km east of Addis Ababa and Metehara 250 km east of Addis. A new factory is planned at Tendaho in the Afar region, which will employ 80,000. Currently, all factories are state-owned.

¶3. Total sugar production capacity in Ethiopia stands at approximately 275,000 tons per year (tpy). Finchaa has a production capacity of 80,000 tpy, Metahara produces 125,000 tons per year (tpy) and Wonji/Shoa produces 75,000 tpy.

¶4. India's ExIm bank has provided a \$640 million soft loan at 1.75% interest to cover part of an ambitious expansion project. The GoE states that it will finance the balance of \$660 million, but the details of financing are not clear. The expansion project will raise Finchaa's production capacity to 270,000 tpy. The new factory at Tendaho will have a capacity of 600,000 tpy- Ethiopia's largest.

¶5. In addition to the Indian-funded projects, Wonji/Shoa is upgrading its capacity to 350,000 tpy and Metehara will increase capacity to 190,000 tpy. A private Pakistani investor has been granted permission to develop a 70,000 hectare sugar plantation and factory in Oromia, which will be the country's first private-sector sugar project. In total, the new factory at Tendaho along with expansion at Finchaa, Wonji/Shoa and Metehara will raise production capacity to 1.41 million tpy.

#### Why Sugar and Why Now?

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¶6. At first glance, sugar is an odd sector for such aggressive and rapid expansion. Sugar is notorious as one of the most volatile commodities, with frequent and large price fluctuations. Ethiopia is poised, however, to take advantage of several factors that may make their sugar investment pay off. First, Ethiopia's domestic

demand for sugar is rising as the country develops. New candy and cookie factories have increased industrial demand, and as rural farmers gain income through increased commodity prices they are substituting sugar for more traditional honey or salt in coffee. Currently, domestic demand is about 300,000 tpy, in excess of national production.

¶17. In addition to satisfying the domestic sweet tooth, Ethiopia is taking advantage of the European Union's "Everything but Arms" program. This program offers the ability for certain least developed countries, including Ethiopia, to export sugar tariff-free to the EU. Ethiopia plans to export 24,000 tons of raw sugar to Portugal. This export, while it may currently be at the expense of domestic consumption, will earn much-needed hard currency for the foreign-exchange strapped GoE. Once the proposed expansions and new factory are on-line, Ethiopia should be able to both meet domestic needs and export up to its quota for EBA and have excess to sell on additional world markets.

¶18. Another reason Ethiopia is eyeing increased sugar production is not sugar itself, but a byproduct -- ethanol. Ethiopia is 100% dependent on outside sources for petroleum products, and the country's fuel bill takes up 75% of its export revenues. Ethanol is cheaper than benzene (gasoline) by about 6 birr per liter at current prices and its use would save scarce foreign currency reserves. With this in mind, the Ministry of Mines and Energy has initiated a program of fuel blending, with the aim of substituting 30 million liters of benzene per year with ethanol.

¶19. Beginning in October 2008, fuel stations in Addis Ababa will sell a blend of 95% benzene and 5% ethanol. Finchaa is currently the only factory producing ethanol, in the amount of 8 million liters per year. Plans are in place to increase Finchaa's ethanol production to 17 million liters per year. Wonji/Shoa plans to begin

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ethanol production in 2008 with an initial capacity of 12.2 million liters per year. The new Tendaho factory will have the greatest ethanol impact with a 17.6 million liter per year potential, bringing total production to nearly 37 million liters per year.

¶10. Ethanol can also be used in clean-cooking stoves as a substitute for kerosene or biomass. As kerosene prices rise in tandem with other petroleum products and the population, especially in urban areas, moves into more dense housing, these clean-burning stoves are important for economic, environment and health reasons. Currently, the GoE is reluctant to make ethanol available for projects other than fuel blending.

#### Not So Sweet Side Effects

¶11. While touted as an environmentally-friendly fuel, ethanol has advantages and disadvantages. If it is solely a byproduct of existing sugar plantations and if it is used for stoves that mitigate the use of biomass, then it is very environmentally friendly. If, on the other hand, sugar is grown as a biofuel crop that requires excessive inputs of water and fertilizer and displaces food crops or rangelands, and if the ethanol is then used for fuel blending it is not environmentally friendly.

¶12. The massive construction at Tendaho is taking place in an area primarily inhabited by pastoralist Afars. A 2.8 billion cubic meter dam will be constructed on the nearby Awash River to provide irrigation for the plantation's 60,000 hectares of cane. A press release in 2007 from the Afar Human Rights Organization (AHRO), however, states that up to 500,000 pastoralists could be displaced by the dam and plantation. The GoE states that 10,000 hectares of land have been set aside for the pastoralists to develop for pasture or to use for sugarcane cultivation. However, the reduction in their rangeland and/or settlement for cane cultivation represents significant disruptions to the traditional livelihoods of the pastoralists.

¶13. AHRO is also concerned about hundreds of thousands of "highlanders" (a term typically used to denote ethnic Tigrayan or

Amhara Ethiopians) being brought into their territory to construct the dam and later staff the plantation and factory. The Afars also state that the Awash River, already polluted, will be further damaged by the industrial waste from the factory and fertilizers used for cane cultivation, thus posing an environmental threat to their livelihoods.

¶14. COMMENT: Ethiopia is in the midst of an attempt to transform its economy in order to lift its population from the lowest rungs of development and poverty. By concentrating on sectors where it has a natural competitive advantage, particularly agriculture-related sectors, Ethiopia hopes to boost exports, foreign exchange earnings, employment, and GDP. Sugar had emerged recently as a potential "sweet spot" for Ethiopian economic development. Sugar is a risky gamble, though, based on world market volatility and environmental concerns. The sugar gamble can be seen as a grab for foreign exchange on two fronts- first by exporting sugar at the expense of the domestic market in exchange for foreign exchange and second by substituting indigenous ethanol for imported benzene. Post will continue to monitor this sector both to see if the GoE's plans come to fruition and to determine any unhealthy outcomes of Ethiopia's sugar binge. END COMMENT.

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